



**BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF CALIFORNIA**

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Order Instituting Rulemaking to Implement
the Commission's Procurement Incentive
Framework and to Examine the Integration
of Greenhouse Gas Emissions Standards into
Procurement Policies.

CPUC Docket: R.06-04-009

**COMMENTS OF CONSTELLATION NEWENERGY, INC., AND
CONSTELLATION ENERGY COMMODITIES GROUP, INC ON
ALJ RULING REQUESTING COMMENTS AND NOTICING WORKSHOP
ON ALLOWANCE ALLOCATION ISSUES**

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I. Introduction and Summary

On October 15, 2007, Administrative Law Judges Turkeurst and Lakritz issued a *Ruling Requesting Comments and Noticing Workshop on Allowance Allocation Issues* ("ALJ Ruling"). Constellation Energy Commodities Group, Inc. and Constellation NewEnergy, Inc. (collectively, "Constellation") appreciate the opportunity to submit this response to the questions contained therein. Constellation is also concurrently filing these Comments in Energy Commission Docket No. 07-OIIP-01 pursuant to the ALJ Ruling.

Through its early attention to addressing global climate change, California has placed itself at the forefront of implementing programs that will reduce greenhouse gas ("GHG") emissions in a meaningful and efficient manner. Constellation supports California's efforts and appreciates that the program could serve as a valuable stepping stone toward the development of a national program. Constellation wishes to emphasize that the timely implementation of a single, U.S. greenhouse gas reduction program is critical if the efforts undertaken by California are to have lasting environmental impact while minimizing disruptions to California's economy.

Constellation strongly believes that the implementation of a well-designed, market-based cap and trade system is an essential tool for achieving emission reductions across various economic

sectors. Use of competitive forces within a cap and trade regime will provide the incentives for economic investment and efficient technological innovations necessary to achieve the desired environmental improvements. As a “first mover” on climate change policy, California decision makers and regulators must take special care to ensure that efforts in California can and will be integrated into existing and emerging national and international markets and global efforts to address greenhouse gas emissions.

Prior to answering the questions posed in the ALJ Ruling, Constellation first refers to the primary regulatory approaches for effective GHG programs contained in the *Recommendations for Designing a Greenhouse Gas Cap-and Trade System for California: Recommendations of the Market Advisory Committee to the California Air Resources Board* (“MAC Report”), issued on June 30, 2007 which are summarized as follows¹:

- 1) The program should eventually include all major greenhouse gas-emitting sectors of the economy in the cap-and-trade program.
- 2) To address emission associated with imported electricity within a state-based cap-and-trade program, the Committee recommends a “first-seller” approach.
- 3) The Committee recommends a combined approach in which some share of allowances is allocated free of charge initially, while the remaining allowances are auctioned. The percentage of allowances auctioned should then increase over time.
- 4) The Committee recommends that California’s cap-and-trade program recognize offsets generated both within and outside the state’s borders.
- 5) California should encourage linkages with other mandatory greenhouse gas cap-and trade system.

¹ Market Advisory Committee “Recommendations for Designing a Greenhouse Gas Cap-and-Trade System for California,” (“MAC Report”), Executive Summary, pages iv and v.

As explained further in its responses to the ALJ Rulings’ specific questions, Constellation currently supports the following approaches with respect to emission allowances to facilitate the development of a well-designed and robustly competitive cap-and-trade system:²

- A. The point of regulation should be the emitting resources - a source-based approach. In order to address the issue of imports, Constellation agrees that the first seller approach may be appropriate, although there are significant issues that must be addressed with respect to how importers of power will acquire allowances. Furthermore, as neighboring states and countries adopt emission caps, either through state or federal mandates, power imported to California from those neighbors should cease to be subject to first-seller obligations in California.
- B. At the outset of a cap-and-trade program, there should be a 50/50 split between the allocation of allowances to emitting resources and an auction of allowances.
- C. Allowances should be allocated using an “output” based methodology.
- D. Auctions should be open, transparent and conducted in advance of the compliance period to support investment decision making. The auction should be conducted by an independent entity.

While Constellation’s comments here necessarily focus on the electric sector, Constellation strongly believes that a meaningful GHG emission reduction strategy requires all emitting sectors to be subject to emission reduction mandates so as to increase the potential for cross-sector innovation and efficiency in developing GHG reduction strategies.

Finally, Constellation notes that the November 5 Workshop and subsequent stakeholder discussions will provide a valuable exchange of information and viewpoints. Constellation intends

² Constellation reiterates that the positions stated here represent Constellation’s current thinking on emission allowance related issues. Constellation expects that discussion at the November 5 Workshop and subsequent discussions will inform its viewpoints, and therefore reserves the right to modify its positions as the discussions continue.

to actively participate in those discussions; what it learns may lead to modifications to the positions stated here. Therefore, Constellation reserves the right to so modify its positions as this important stakeholder process continues.

II. Constellation Response to Questions Contained in the ALJ Ruling

A. Section 3.1: Evaluation Criteria

Q1. Please comment on each of the criteria listed by the MAC. Are these criteria consistent with AB 32? Should other criteria be added, such as criteria specific to the electricity and/or natural gas sectors? In making trade-offs among the criteria, which criteria should receive the most weight and which the least weight?

Answer: The principles that MAC agreed would “guide its work in developing an efficient, equitable, and effective program design”³, and Constellation’s comments on them are as follows:

1) avoiding localized effects or disproportionate impacts on low-income communities or communities already adversely affected by air pollution.

Distributing emission allowances and designing programs that will create incentives for increased deployment of existing clean technologies and the discovery of innovative new technologies will bring both environmental and potentially new economic benefits to all segments of society. Nevertheless, Constellation agrees that care must always be taken when implementing new regulations, and imposing new mandates to ensure that the economic impacts are fully understood and that those who need assistance and protection receive it. Social well-being programs, however, do not necessarily need to be nor should they be an integral part of the discussion of how to distribute emission allowances, and efforts to do so may unnecessarily complicate the mechanisms.

2) rejecting approaches that might weaken existing environmental regulations.

Constellation supports this principle to the extent it means that an approach that creates an environmental improvement in one area, but degrades environmental improvements in other areas, should be avoided. However, there may be a need, as new technologies evolve, to modify existing regulations—or expedite the ordinary processing of environmental reviews—in order to obtain the full benefit of those new and/or improved technologies on the timelines needed to meet GHG emission reduction goals. For instance, there can be no deployment of new and clean nuclear technology in California without a comprehensive review of the legislative and regulatory mandates relative to nuclear waste storage technologies. Another example, already under some discussion, is how regulations with respect to renewable portfolio standards will interact with GHG emission reduction regulations. The principles that govern the development of efficient, equitable, and effective programs must not become restrictive or overly proscriptive, because new and valuable

³ See MAC Report, Executive Summary, page iii.

ideas and approaches could be prematurely dismissed to the detriment of meeting California's very aggressive GHG emission reduction goals.

3) encouraging practical, cost effective emission reductions

Constellation supports this principle, and would consider this a high priority for consideration during the development and evaluation of efficient, equitable, and effective program design.

4) minimizing transaction costs associated with compliance

Constellation supports this principle, and would consider this also a high priority, along with principle #3 above. Achieving GHG emission reductions will likely be a costly endeavor. Administrative and transactional efficiency should be carefully considered in development of the GHG emission reduction regulations, as with any market design, in order to minimize the overall cost burden of environmental improvement and to ensure that expenditures are focused as much as possible on activities that will create the desired environmental improvement.

5) providing a leadership example for other states and countries.

California's efforts to date regarding GHG emission reductions are significantly ahead of many other states and nations, placing California in a *de facto* leadership role, as evidenced by Governor Schwarzenegger's participation in the International Carbon Action Partnership. This principle, therefore, should be about providing leadership for approaches that can be initially adopted, expanded and integrated with other efforts occurring elsewhere. To assure that California's current leadership position is complimentary with other efforts in combating a global issue, the implementation of AB 32 must continuously consider how its emission reduction measures and programs can be developed so that they will leverage their in-state impact to other states.

B. Section 3.2: Basic Options

Q2. Broadly speaking, should emission allowances be auctioned or allocated administratively, or some combination?

Answer: Constellation agrees with the general concepts described in the MAC Report's third key recommendation that a "combined approach in which some share of allowances is allocated free of charge initially, while the remaining allowances are auctioned. The percentage of allowances auctioned should then increase over time."⁴ For the initial stages of California's cap-and-trade program, Constellation believes that a 50-50 split between a free allocation of allowances and an auctioning of the balance of allowances best strikes the appropriate balance between the need to accomplish GHG emission reductions while simultaneously mitigating some of the impacts on developing markets, investment in new technologies, consumers' costs, and compliance costs for existing emission sources and new entrants. Over time, Constellation believes that the initial 50-50

⁴ See MAC Report, Executive Summary, page iv.

split should transition to a 100% auction system for the distribution of allowances which will serve as a valuable market development tool offering price transparency and market efficiencies.

In addition, Constellation believes that any allowance distribution system should set-aside a small portion of allowances for use with renewable energy sales in the voluntary renewable energy market. This mechanism is included, for example, as an option in the Regional Greenhouse Gas Initiative (“RGGI”) Model Rule Section XX-5.3(d).⁵ Determining the specific set-aside amount is an appropriate topic for workshops, however the minimum set-aside amount should support the existing volume of voluntary renewable energy purchases in the state. Any set-aside allowances not used within some pre-established time frame should be returned to the broader allowance market for auctioning. Constellation believes this set-aside policy will help support an evolving voluntary carbon-neutral electricity market in the state by ensuring that the state’s renewable energy development efforts complement the state’s GHG cap-and-trade program. Moreover, despite California’s aggressive Renewable Portfolio Standard (“RPS”) Program, many of the state’s government entities, institutions and corporations have shown that they want to make voluntary renewable purchases that go beyond the RPS requirements imposed on their electricity providers. A significant number of these entities have joined various initiatives to reduce their carbon footprint through voluntary purchases of renewable energy to meet all or portions of their electric load. For example, Appendix A provides an illustrative list of California-based entities that have made voluntary public commitments through the United States Environmental Protection Agency’s (“U.S. EPA”) Green Power Partnership. The inclusion of a set-aside policy for voluntary renewable purchases in the final allowance distribution system will greatly help to ensure that voluntary purchases continue to grow in California.

Q3. If you recommend partial auctioning, what proportion should be auctioned? Should the percentage of auctioning change over time? If so, what factors should be used to design the transition toward more auctioning?

Answer: As stated in our response to Q2 above, Constellation believes that the initial 50-50 free allocation vs. auction split should transition to a 100% auction system over time. At this time, Constellation does not have a specific recommendation on the timing for phasing-in a 100% auction system and feels that this is an appropriate topic for workshops. However, as an overarching principle, Constellation believes that the phase-in process must be clearly established and made known to all obligated entities well in advance of compliance deadlines to allow such entities to assess compliance options and to plan for any economic impacts.

Q4. How should new market entrants, such as energy service providers, community choice aggregators, or (deliverer/first seller system only) new importers, obtain emission allowances, i.e., through auctioning, administrative allocation, or some combination?

Answer: Under a source-based compliance approach, a small set-aside of allowances available for new generation could be created that reflect then-current technologies, anticipated replacement of existing generation resources, and potential new imports. These allowances could be provided to the new entrants at market clearing prices. Any unused allowances held in such a set-aside should be made available to the broader market. A liquid secondary allowance market under the cap and

⁵ Regional Greenhouse Gas Initiative (“RGGI”) Model Rule, page 47.

trade program will be an important resource for new and existing emitting generation to obtain any allowances needed to achieve compliance.

Under a load-based approach, there should also be a set aside for new load serving entrants, although the compliance and oversight scenario becomes notably more complex because the number and identity of potentially regulated entities is not readily fixed. This level of complexity is one reason that Constellation supports the source based approach; if a load based approach is adopted, the issue of allocations for new entrants should be discussed in more detail.

C. Section 3.3: Auctioning of Emission Allowances – General Questions

Q5. What are the important policy considerations in the design of an auction?

Answer: An auction platform should be open and transparent to encourage liquidity and provide credible price discovery to the market. Auctions should occur periodically to distribute set portions of the allowance budget into the market over time. Allowances should be auctioned well in advance of the compliance true-up period to allow covered entities to access compliance options and economic impacts, particularly relative to major capital improvement programs or new technology investments.

Constellation also wishes to emphasize the importance of focusing auction revenues on the greenhouse gas reduction related purposes.

Q6. How often should emission allowances be auctioned? How does the timing and frequency of auctions relate to the determination of a mandatory compliance period, if at all?

Answer: Auctions should occur periodically and well in advance of the compliance true-up period to allow obligated entities the opportunity to assess compliance options and make sound budgeting, investment and financing decisions. Quarterly auctions would be good for providing price discovery to the market, in particular for a new market in which initial information is limited. However, at a minimum, one auction must be held per allowance vintage.

Q7. How should market power concerns be addressed in auction design? If emission allowances are auctioned, how would the administrators of such a program ensure that all market participants are participating in the program and acting in good faith?

Answer: In addition to general market monitoring activities that exist within the energy markets, each of the following measures would serve to address market power concerns associated with the auction of allowances:

- Limiting an auction to 50% of the allowance distributions at the outset of the compliance program (as described in the response to Q2) will serve to partially address the market power concerns associated with the auction.
- Including offsets as a means to demonstrate compliance will mitigate market power concerns and will also serve to mitigate the price volatility of allowances. In this regard, Constellation urges the ALJs and Commission to ensure that the November 5

Workshop include a discussion of how offsets can be integrated into its allowance distribution and compliance mechanisms.

- Implementing a well-designed auction structure that is open and transparent, with an easy to use interface and no barriers to participation should serve to address many market power concerns, alleviating any need for safety-valve price caps. Such price caps should, if employed at all, represent a mechanism to preclude catastrophic market outcomes, not as a measure to keep prices low or to provide a way for entities subject to the cap to simply pay their way out of compliance.

Q8. What criteria should be used to designate the types of expenditures that could be made with auction revenues (including use to reduce end user rates), and the distribution of money within those categories?

Answer: One of the most important issues associated with the auctioning of allowances is the issue of how will the auction revenues be spent. Constellation strongly believes that the revenues should be invested in greenhouse gas emission reduction related purposes. Just as energy efficiency is seen as a critical part of near term reductions, development of new technologies will be essential for long term reductions. Accordingly, policies should be clear that rather than simple rate mitigation that may mute the price signals associated with GHG emissions from a sector, the revenues should be applied to support programs that can benefit the overarching goal of GHG emissions reductions such as R&D efforts for promising technologies.⁶

Q9. What type of administrative structure should be used for the auction? Should the auction be run by the State or some other independent entity, such as the nonprofit organization being established by the Regional Greenhouse Gas Initiative?

Answer: Constellation believes that it will be important that there be a single allowance auction format to facilitate the deployment of allowance cap and trade program across as inter-state and international boundaries. Constellation also believes, in general, that the auctions should be conducted by an independent entity, but does not have an opinion at this time on whether that should be the state or a third party, as with the Regional Greenhouse Gas Initiative (“RGGI”). In addition, in its response to Q25, Constellation describes its concerns with proposal to have jurisdictional retail sellers conduct the auctions.

D. Section 3.4.1: Electricity Sector: Administrative Allocation of Emission Allowances

Q10. If some or all allowances are allocated administratively, which of the above method or methods should be used for the initial allocations? If you prefer an option other than one of those listed above, describe your preferred method in detail. In addition to your recommendation, comment on the pros and cons of each method listed above, especially regarding the impact on market performance, prices, costs to customers, distributional consequences, and effect on new entrants.

⁶ See, e.g., a structure like the California Energy Commission’s Public Interest Energy Research (“PIER”) program. <http://www.energy.ca.gov/pier/index.html>

Answer: At this time, Constellation supports an output-based approach to the allocation of allowances. Under such an approach, allowances would be allocated for free to electric generators according to the megawatt-hours of electricity output they produce, without reference to the individual resources emission factor. Such an approach appears to create a direct financial incentive for investments in efficiency upgrades in fossil-fueled power plants and encourages the deployment of low carbon resources because on a CO₂e basis those resources will have a lower allowance requirement. Furthermore, output-based allocations appears to encourage efficiency and technological innovation in all forms of generation including clean sources like renewables and nuclear which should also receive allocations under such a proposal. Finally, the approach will provide incentives for development of diversified resource portfolios that may better balance the reliability needs against the resource performance characteristics and emission profiles.

Q11. Should the method for allocating emission allowances remain consistent from one year to the next, or should it change as the program is implemented?

Answer: The method for allocating emission allowances should remain consistent from one year to the next to foster the regulatory stability that will create the long term price transparency necessary to advance investments. An output based updating methodology will provide this consistency. The number of allocations each “allocation year” would be determined based on prior years’ output levels. In this way, the allowances are redistributed based on recent performance of the plant. This keeps the allocations in line with the actual operation of the plants. It phases out allocations to plants that are no longer running and increases allocations to new plants as they provide increased generation to consumers. This is consistent with most of the state rules for the NO_x SIP Call. The baseline is recalculated each year in which the allocation is determined, referred to as the “allocation year.”

Q12. If new market entrants receive emission allowance allocations, how would the proper level of allocations be determined for them?

Answer: Constellation does not have specific, finalized suggestions at this time about how each new entrant would receive emission allowance allocation, but refers to its response to Q4 that talks generally about how new entrants could be accommodated in a program where emission allowances are being allocated rather than auctioned. Once all allowances are auctioned, new sources would seek allowances through the auctions and secondary market along with existing sources.

Q13. If emission allowances are allocated based on load/sales, population, or other factors that change over time, how often should the allowance allocations be updated?

Answer: As note in the response to Q10, Constellation currently prefers that allocations be based on source based, output calculations, but does not have an opinion at this time on the frequency of updates to the emission allowance allocations, except to state that the allocation updates should be spaced to allow for the allocations to accommodate normal business cycles.

Q14. If emission allowances are allocated based on historical emissions (“grandfathering”) or benchmarking, what base year(s) should be used as the basis for those allocations?

Answer: As noted in the response to Q10, Constellation currently supports an allocation of allowances based on an output methodology, rather than on historical emissions, on the premise that the output methodology will create direct financial incentives for investing in power plant efficiency upgrades and will best encourage the deployment of low carbon resources. An output-based allocation will encourage efficiency in all forms of generation including clean sources like renewables and nuclear, which might also receive allocations under such a proposal. At this point in time, Constellation's thinking is that the base year for the allocation should be 2006, the year that AB 32 was signed providing the formal signal that GHG reduction regulation should be part of business planning. However, Constellation looks forward to further discussion of this timing issue.

Q15. If emission allowances are allocated based initially on historical emissions (“grandfathering”), should the importance of historical emissions in the calculation of allowances be reduced in subsequent years as providers respond to the need to reduce GHGs? If so, how should this be accomplished? By 2020, should all allocations be independent of pre-2012 historical emissions?

Answer: As noted in the response to Q10, Constellation does not currently support the allocation of allowances based on historical emissions, and so does not have a position on this issue at this time.

Q16. Should a two-track system be created, with different emission allowances for deliverers/first sellers or retail providers with legacy coal-fueled power plants or legacy coal contracts? What are the factors and trade-offs in making this decision? How would the two tracks be determined, e.g., using an historical system emissions factor as the cut-off? How should the allocations differ between the tracks, both initially and over time? What would be the market impact and cost consequences to consumers if a two-track method were used?

Answer: In general, Constellation does not support the concept that legacy coal plants or legacy coal contracts should receive emission allocations pursuant to a different methodology than other emitters. However, it is not entirely clear to Constellation how this two track system would work, and presumes that this will be discussed at the upcoming Workshop. Constellation may provide further comment on this issue after having the benefit of the discussion that take place there.

Q17. If emission allowances are allocated administratively to retail providers, should other adjustments be made to reflect a retail provider's unique circumstances? Comment on the following examples, and add others as appropriate:

- a. Climate zone weighting to account for higher energy use by customers in inclement climates, and**
- b. Increased emission allowances if there is a greater-than-average proportion of economically disadvantaged customers in a retail provider's area.**

Answer: Constellation reserves the right to comment further on this question after it has been discussed at the Workshop. However, as an initial matter, it seems that allocation criteria for a load-based approach, such as climate zone weighting and economically disadvantaged geographic boundaries, could lead to an allowance allocation that is very complex and perhaps unwieldy from an administrative and market perspective. Such complexity may ultimately hamper the effectiveness of the cap and trade program, reducing its ability to incent environmental

improvement. Therefore, the benefits of such measures must be carefully weighed against the complexity it will create.

Q18. Should differing levels of regulatory mandates among retail providers (e.g., for renewable portfolio standards, energy efficiency investment, etc.) be taken into account in determining entity-specific emission allowance allocations going forward? For example, should emission allowance allocations be adjusted for retail providers with high historical investments in energy efficiency or renewables due to regulatory mandates? If those differential mandates persist in the future, should they continue to affect emission allowance allocations?

Answer: Constellation notes that this issue appears to be applicable only under a load-based point of regulation approach, whereas Constellation supports a source-based approach, with emitting resources as the point of regulation. That said, Constellation does not believe that differing levels of regulatory mandates among retail providers should be taken into account in determining entity-specific allowance allocations. Since compliance with other regulatory mandates such as RPS and energy efficiency requirements assists obligated entities in meeting their GHG reduction targets, such entities should not receive additional allocations or have their allocations adjusted due to compliance with other regulatory mandates. However, if an historic emission allocation system is adopted, consideration must be given to setting the base year prior to the imposition of the other regulatory mandates so that the obligated entities are not penalized for emission reductions already achieved in compliance with the other mandates.

Q19. How often should the allowance allocation process occur? How far in advance of the compliance period?

Answer: See response to Q6. Constellation's comments about when allowance auctions should be held are equally applicable to when allowance allocations should occur.

Q20. What are the distributional consequences of your recommended emission allowance allocation approach? For example, how would your method affect customers of retail providers with widely differing average emission rates? Or differing rates of population growth?

Answer: Constellation does not have thoughts to share on this question at this time, but reserve the right to comment at a later time.

E. Section 3.4.2: Electricity Sector: Emission Allowances with a Deliverer/First Seller Point of Regulation

Q21. Would a deliverer/first seller point of regulation necessitate auctioning of emission allowances to the deliverers/first sellers?

Answer: As noted in the response to Q2, Constellation supports a 50% allocation of allowances and 50% auction of allowances at the outset of the program, with a gradual transition to 100% auction. Constellation supports this approach whether the point of regulation is load-based or deliverer/first seller. With the deliverer/first seller approach, special consideration will have to be

paid to how allowances will be distributed to first sellers who are importing power, but do not rely on specific supply contracts. Constellation urges that this topic be addressed at the upcoming Workshop.

Q22. Are there interstate commerce concerns if auction proceeds are obtained from all deliverers/first sellers and spent solely for the benefit of California ratepayers? If there are legal considerations, include a detailed analysis and appropriate legal citations.

Answer: Constellation has not conducted a thorough legal analysis of this question.

Q23. If you believe 100% auctioning to deliverers/first sellers is not required, explain how emission allowances would be allocated to deliverers/first sellers. In doing so, answer the following:

a. How would the amount of emission allowances given to deliverers/first sellers be determined during any particular compliance period?

Answer: Constellation believes that the 50% of allowances that are allocated should be done so utilizing an output-based methodology, as described in its answer to Q10. Furthermore, as noted in the response to Q21, Constellation acknowledges that the issues associated with the allocation of allowances to importers needs specific discussion and resolution.

b. How would importers that are marketers be treated, e.g., would they receive emission allowance allocations or be required to purchase all their needed emission allowances through auctions? If allocated, using what method?

Answer: See response to Q23(a) and Q21.

c. How would electric service providers be treated?

Answer: Under the deliverer/first seller approach, electric service providers (“ESPs”) would not be the point of regulation, and thus would not receive any allocation of allowances unless they also happen to own in-state generation or import power. In either case, the allocation of allowances to ESPs would be done pursuant to the same methodologies that are adopted for non-ESPs entities subject to the cap.

d. How would new deliverers/first sellers obtain emission allowances?

Answer: New deliverers/first sellers could obtain allowances through allocations from a set-aside account, as described in Q4. They could also obtain emission allowances in an auction, if one is incorporated into the market design, or on the secondary trading market. As stated previously, Constellation also finds accommodation of offset projects to be an important part of emissions reductions and compliance.

e. Would zero-carbon generators receive emission allowance allocations?

Answer: Yes, under an output based allocation approach, zero-carbon generators could receive allocations based on their amount of electric output.

f. What would be the impact on market performance, prices, and costs to customers of allocating emission allowances to deliverers/first sellers?

Answer: As noted in the response to Q2, Constellation believes that a combination of allocation and auction of allowances is the most efficient way to initiate emission reduction compliance, maximize market incentives for investment in emission reduction technologies, while transitioning to a full auction approach.

g. What would be the likelihood of windfall profits if some or all emission allowances are allocated to deliverers/first sellers?

Answer: A free allocation of allowances does provide the companies receiving the allocations to profit from the optimal deployment of that new allowance asset, but it must be kept in mind that those entities also face significant compliance costs in order to achieve the GHG reductions necessary to continue to operate. Constellation believes that allocations that transition to 100% auction will minimize concerns over windfall profits while supporting establishment of a viable market.

h. How could such a system prevent windfall profits?

Answer: See response to Q23g.

Q24. With a deliverer/first seller point of regulation, should administrative allocations of emission allowances be made to retail providers for subsequent auctioning to deliverers/first sellers? If so, using what allocation method? Refer to your answers in Section 3.4.1., as appropriate.

Answer: Constellation is concerned about the allocation of allowances under the deliverer/first seller approach to the jurisdictional retail providers for subsequent auctioning to the deliverers/first sellers, for the following reasons:

- First, allocating allowances to a jurisdictional retail provider – when the jurisdictional retail provider also owns emitting resources – would create a significant conflict of interest for the retail provider. Specifically, there would be a conflict between the retail provider’s objective of selling the allowances at the highest price so as to maximize the revenues from the auction, and the objective of purchasing allowances for its owned and/or controlled generation at the lowest possible price to minimize its expenses. While auction rules could perhaps be developed to minimize the impact this inherent conflict may have on how the retail sellers conducted the auction, it is Constellation’s opinion that it may be best to avoid this conflict altogether by having an independent entity conduct the auction.
- Second, a jurisdictional retail provider would have a similar conflict if the retail provider’s service territory allows retail choice or direct access. In this instance, the jurisdictional retail provider who runs the auction of the allowances, would have a conflict between maximizing the auction revenues and a potential desire to see the allowances sold at a lower price to the wholesale suppliers from whom it purchases

energy so as to lower its costs vis a vis competitive retail suppliers, with an inappropriate and unintended so that the jurisdictions retail provider's customers would have less incentive to choose an alternative supplier. Again, while auction rules could perhaps be developed to minimize the impact that such conflicts of interest may have on the conduct of the auction, Constellation believes that such conflicts may be best avoided by having an independent entity conduct the auction.

However, to the extent that it is determined that auction revenues should be directly returned to consumers through distribution rates, the jurisdictional retail providers are the appropriate conduit, and allowance of allowances to them for re-auction could be considered. However, there would need to be in place specific provisions to ensure that the unintended outcomes described above could not occur.

Q25. If you recommend allocation of emission allowances to retail providers followed by an auction to deliverers/first sellers, how would such an auction be administered? What kinds of issues would such a system raise? What would be the impact on market performance, prices, and costs to customers?

Answer: See response to Q24.

F. Section 3.5: Natural Gas Sector

Constellation's responses herein are with respect to the electric sector only. While we do not have comments from the natural gas sector perspective at this time, we reserve the right to comment in the future.

Q26. Answer each of the questions in Section 3.4.1. except Q16, but for the natural gas sector and with reference to natural gas distribution companies (investor- or publicly-owned), interstate pipeline companies, or natural gas storage companies as appropriate. Explain if your answer differs among these types of natural gas entities. Explain any differences between your answers for the electricity sector and the natural gas sector.

Q27. Are there any other factors unique to the natural gas sector that have not been captured in the questions above? If so, describe the issues and your recommendations.

G. Section 3.6: Overall Recommendation

Q28. Considering your responses above, summarize your primary recommendation for how the State should design a system whereby electricity and natural gas entities obtain emission allowances if a cap and trade system is adopted.

Answer: Constellation supports the adoption of a cap and trade program under a source-based/first-seller point of regulation that can be seamlessly integrated into a future national cap and trade program. Constellation believes that the proper design of an allowance distribution system is a critical component of the overall program and that the following are

key elements: 1) an initial 50/50 allowances split between free allocations and auctions eventually transitioning to 100% auction of allowances; 2) an output-based allocation mechanism; and 4) the distribution of allowances in a forward time frame to allow entities subject to the cap to manage the emission reduction mandates. Myriad other issues warrant careful consideration during the upcoming stakeholder discussions, such as allowance set asides for voluntary renewable projects, how and who will conduct the auction, and what the pace of the transition to full auction. Constellation looks forward to participating in the discussion of these important issues.

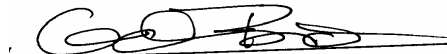
Respectfully submitted,

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Appendix A

Table 1: U.S. EPA Green Power Partnership – CA Partners List

Name	Partner Services	Leadership Club	State
<u>Affordable Internet Services Online</u>	Information Technology	Leadership Club	CA
<u>Agilent Technologies / Santa Clara location</u>	Information Technology		CA
<u>Alameda County's StopWaste.Org</u>	Govt. (Local, Municipal)		CA
<u>Alameda County, CA / GSA Facilities</u>	Govt. (Local, Municipal)		CA
<u>American Apparel Factory Headquarters</u>	Clothing & Textile		CA
<u>American Honda Motor Co. / Gresham, OR Facilities</u>	Automotive	Leadership Club	CA
<u>Amyris Biotechnologies</u>	Health Care		CA
<u>Applied Materials, Inc.</u>	Information Technology		CA
<u>Beautyland Beauty Supply</u>	Retail	Leadership Club	CA
<u>Blake's Auto Body of Rohnert Park, CA</u>	Automotive		CA
<u>Boulder Associates / Sacramento, CA Office</u>	Architecture Srvcs.	Leadership Club	CA
<u>Butte County, CA / Government Center</u>	Govt. (Local, Municipal)		CA
<u>Butte-Glenn Community College District</u>	Education (Higher)	Leadership Club	CA
<u>California Graphics, Inc.</u>	Media, Print & Publishing		CA
<u>California State University System</u>	Education (Higher)	Leadership Club	CA
<u>Center for Resource Solutions</u>	Non-Profit (NGO)		CA
<u>Chautauqua Natural Foods</u>	Food & Beverage	Leadership Club	CA
<u>Cisco Systems, Inc.</u>	Information Technology	Leadership Club	CA
<u>City of Chico, CA</u>	Govt. (Local, Municipal)		CA
<u>City of Fresno, CA / General Services Department</u>	Govt. (Local, Municipal)	Leadership Club	CA
<u>City of Livermore, CA / City Hall</u>	Govt. (Local, Municipal)		CA
<u>City of Mt. Shasta, CA</u>	Govt. (Local, Municipal)		CA
<u>City of Palo Alto, CA</u>	Govt. (Local, Municipal)		CA
<u>City of San Diego, CA</u>	Govt. (Local, Municipal)	Leadership Club	CA
<u>City of San Francisco/Moscone Convention Center</u>	Govt. (Local, Municipal)	Leadership Club	CA
<u>City of San Jose, CA WWTP</u>	Govt. (Local, Municipal)		CA
<u>City of Santa Barbara, CA / El Estero WWTP</u>	Govt. (Local, Municipal)	Leadership Club	CA
<u>City of Santa Clara, CA / City Hall</u>	Govt. (Local, Municipal)		CA
<u>City of Santa Clara, CA / Library</u>	Govt. (Local, Municipal)		CA
<u>City of Santa Clara, CA / Senior Center</u>	Govt. (Local, Municipal)		CA

<u>City of Santa Monica, CA</u>	Govt. (Local, Municipal)	Leadership Club	CA
<u>City of Vallejo, CA / City Hall</u>	Govt. (Local, Municipal)		CA
<u>Clif Bar</u>	Food & Beverage	Leadership Club	CA
<u>Domaine Carneros Winery</u>	Wineries & Breweries	Leadership Club	CA
<u>Earth Island</u>	Food & Beverage		CA
<u>East Bay Municipal Utility District/Main WWT Plant</u>	Govt. (Local, Municipal)	Leadership Club	CA
<u>Ecology Action of Santa Cruz</u>	Non-Profit (NGO)	Leadership Club	CA
<u>FedEx Express / Oakland Hub Facility</u>	Transport & Shipping		CA
<u>Fetzer Vineyards</u>	Wineries & Breweries	Leadership Club	CA
<u>ForestEthics</u>	Non-Profit (NGO)	Leadership Club	CA
<u>Frog's Leap Winery</u>	Wineries & Breweries		CA
<u>Garden Court Hotel</u>	Travel & Leisure		CA
<u>Garuda International, Inc.</u>	Retail		CA
<u>Global Neuroscience Initiative Foundation</u>	Non-Profit (NGO)	Leadership Club	CA
<u>GreenerPrinter</u>	Media, Print & Publishing	Leadership Club	CA
<u>Greenest Host</u>	Information Technology		CA
<u>Hewlett-Packard</u>	Information Technology		CA
<u>IBEW Local 332</u>	Non-Profit (NGO)		CA
<u>IDEO / Palo Alto Facility</u>	Consulting Svcs.		CA
<u>Instant Karma Films</u>	Media, Print & Publishing		CA
<u>Kelley Stoltz</u>	Media, Print & Publishing	Leadership Club	CA
<u>Kentfield School District</u>	Education (K-12)	Leadership Club	CA
<u>KeyPoint Credit Union</u>	Banking & Fin. Svcs.		CA
<u>Live Nation / San Francisco</u>	Other		CA
<u>Lockheed Martin / Palo Alto Facilities</u>	Industrial Goods & Svcs.		CA
<u>Lockheed Martin / Plant 1 - Sunnyvale, CA</u>	Industrial Goods & Svcs.		CA
<u>Los Angeles County Sanitation Districts</u>	Govt. (Local, Municipal)	Leadership Club	CA
<u>Los Angeles World Airports</u>	Transport & Shipping		CA
<u>Loyola Marymount University</u>	Education (Higher)		CA
<u>Lunar Design / Palo Alto Facility</u>	Constr. & Eng. Svcs.	Leadership Club	CA
<u>Lundberg Family Farms</u>	Ag. & Nat. Resources	Leadership Club	CA
<u>Macy's, Inc. West Division</u>	Retail		CA
<u>Method Products, Inc.</u>	Consumer Products	Leadership Club	CA
<u>Molletphoto</u>	Other		CA
<u>National Semiconductor / Corporate Headquarters</u>	Information Technology		CA
<u>New Leaf Paper</u>	Consumer Products	Leadership Club	CA

<u>newScale</u>	Other	CA
<u>Oracle Corporation / Austin Facility</u>	Information Technology	CA
<u>Palo Alto (CA) Community</u>	Green Power Community	CA
<u>Palo Alto Regional Water Quality Control Plant</u>	Govt. (Local, Municipal)	CA
<u>Peninsula Conservation Center</u>	Non-Profit (NGO)	CA
<u>Peninsula Packaging</u>	Industrial Goods & Svcs. Leadership Club	CA
<u>prAna</u>	Clothing & Textile Leadership Club	CA
<u>Ridge Vineyards</u>	Wineries & Breweries	CA
<u>Robert Becker, Inc.</u>	Other	CA
<u>Roche / Palo Alto Campus</u>	Health Care	CA
<u>Rodney Strong Vineyards</u>	Wineries & Breweries Leadership Club	CA
<u>Roos Instruments, Inc.</u>	Information Technology Leadership Club	CA
<u>Safeway Inc.</u>	Retail	CA
<u>San Diego City Schools</u>	Education (K-12)	CA
<u>San Mateo County Forensics Lab & PW Facilities</u>	Govt. (Local, Municipal)	CA
<u>Santa Clara University</u>	Education (Higher)	CA
<u>Sephora USA/5 TX Locations</u>	Retail	CA
<u>Sewerage Commission/ Oroville, CA Region</u>	Govt. (Local, Municipal) Leadership Club	CA
<u>Shaklee Corporation</u>	Consumer Products Leadership Club	CA
<u>Sierra Nevada Brewing Company</u>	Wineries & Breweries	CA
<u>Sims Recycling Solutions / Roseville Facility</u>	Industrial Goods & Svcs.	CA
<u>Smucker Quality Beverages</u>	Food & Beverage	CA
<u>SMWM</u>	Constr. & Eng. Svcs. Leadership Club	CA
<u>Social Venture Network</u>	Other Leadership Club	CA
<u>Solano County, CA / Health & Social Services HQ</u>	Govt. (Local, Municipal)	CA
<u>St. Francis Winery</u>	Wineries & Breweries	CA
<u>Stanford University / Synergy House</u>	Education (Higher)	CA
<u>Sugar Bowl Ski Resort</u>	Travel & Leisure Leadership Club	CA
<u>Terremark Worldwide, Inc.</u>	Information Technology	CA
<u>The Plaza Suites</u>	Travel & Leisure	CA
<u>Toyota Motor Sales / Headquarters South Campus</u>	Automotive	CA
<u>Traditional Medicinals</u>	Food & Beverage	CA
<u>University of California, Santa Cruz</u>	Education (Higher) Leadership Club	CA
<u>Viator, Inc.</u>	Travel & Leisure	CA

<u>Wells Fargo & Company</u>	Banking & Fin. Svcs.	Leadership Club	CA
<u>Westfield Valley Fair / Santa Clara, CA</u>	Real Estate	Leadership Club	CA
<u>Xilinx / San Jose Campus</u>	Information Technology		CA
<u>XL Construction Corporation</u>	Constr. & Eng. Svcs.		CA
<u>Yahoo! Inc./Santa Clara Sites</u>	Information Technology		CA
<u>Yolo County, CA / Bauer Health Building</u>	Govt. (Local, Municipal)		CA
<u>Yorkshire Development</u>	Real Estate		CA

CERTIFICATE OF SERVICE

I hereby certify that I have this day served a copy of the “Comments Of Constellation NewEnergy, Inc., And Constellation Energy Commodities Group, Inc On ALJ Ruling Requesting Comments And Noticing Workshop On Allowance Allocation Issues” on all known parties to R.06-04-009 by transmitting an e-mail message with the document attached to each party named in the official service list as required in this Rulemaking. I have also served this same document on the California Energy Commission in Docket No. 07-OIIP-01 as directed in the October 15, 2007 California Public Utilities Commission Ruling in R.06-04-009. Those parties without email addresses or from which I received a delivery failed message were served by first-class mail with postage prepaid.

Executed on October 31, 2007 at Sacramento, California.

/s/

Eric Janssen

R.06-04-009
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[End]

**CEC Docket No. 07-OIIP-01
Service List
October 31, 2007**

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[End]